22

Transforming Organizations

Embracing the Paradox of E and O

MICHAEL BEER

We live in a time of unprecedented change. Global competition and rapid changes in technology and markets force organizations to be adaptive, and capable of transformation. Of the original Forbes 100 in 1917, 61 had ceased to exist by 1987. Of the remaining 39, only 18 stayed in the top 100, and their return was 20% less than the overall market. Of the companies in the original Standard & Poor's (S&P) 500 in 1957, only 74 remained in 1997, and of these only 12 outperformed the S&P 500 between 1957 and 1998 (Foster & Kaplan, 2001). This astounding record of corporate destruction suggests that organizations generally are not adaptive. They are unable to transform their capabilities and behavior to fit a changing business environment.

The inability of corporations to produce sustained performance reflects top management's inability to transform their organization into high commitment *and* performance systems: organizations that achieve sustained high economic performance and develop high commitment in their employees. A study of 1,435 companies in the Fortune 500 list between 1965 and 1995 showed only 11 companies that were able to attain and sustain high performance (cumulative stock returns 6.9 times the general market) for a 15-year period after the beginning of a corporate transformation (Collins, 2001). Failure to transform corporate performance is also reflected in the declining tenure of CEOs from 10.5 years in 1990 to 4.2 years in 2000—an indication that boards of directors, under pressure from capital markets, are increasingly impatient with their ability to lead change.

In this chapter I discuss two opposing theories of organization transformation, the failure of corporate leaders to integrate them, and an emerging theory and method of organization development (OD) for integrating these

opposing perspectives (Beer & Nohria, 2000a). Theory E has as its goals economic value creation and focuses on the hard facets of organizations, financial performance, strategy, structure, and systems. Theory O has as its goal enhancing organization effectiveness and focuses on the organization's culture and its people. I call them theories because the purpose and means for change embedded in the two theories have very different underlying assumptions. I argue that a successful corporate transformation must embrace the paradox represented by these two theories of change. I also argue that the difficulty of enacting one theory *and also* the other necessitates a disciplined strategic change process led by an effective team with diverse perspectives. Without discipline the transformational process tends to favor the leader's dominant theory. Hierarchy, which creates distance between leaders and organization members and makes open dialogue across organization levels so difficult, prevents top management from testing their theory of transformation and revising it to incorporate the "and also." I offer a set of principles to guide such a disciplined process and evidence about their efficacy in helping organizations and their leaders embrace the paradox.

TWO THEORIES OF CHANGE

As the aforementioned data suggest, few senior executives seem to be able to lead a sustained transformation when a changing environment calls for dramatic change. The reason is that there is substantial lack of agreement, indeed confusion, about the purpose of and means for corporate transformations.

Theory E has as its advocates economists, investment bankers, and venture capitalists. The only way to transform an underperforming organization, according to this school of thought, is through a dose of tough, result-oriented, top-down initiatives: reengineering, restructuring, and layoffs driven by managers motivated by financial incentives that align their interest with those of the shareholders (Jensen, 2000). Consider the following example (adapted from Gilson & Cott, 1996):

> Scott Paper embarked on a journey of theory E change in 1994 when Al Dunlap took over as CEO. Scott had participated profitably in the forest product and paper industry since 1879 but ran into profitability problems in the early 1990s. International expansion had stretched resources at a time when the industry was again entering a period of overcapacity, a pattern that had repeated itself many times in this industry. Performance and shareholder returns dropped at an alarming rate. Bowing to pressure from capital markets, the board of directors recruited Dunlap, a turnaround manager with a record of success in restructuring companies. Dunlap immediately ordered a layoff of 11,000 employees, about 42% of Scott Paper's workforce. He sold a number of businesses and closed down a number of its less profitable plants. In the remainder he imposed a strict regime of efficiency measures with the help of external consultants. And within months he fired most of Scott's top management, often after chastising them in public.
>
> At the end of two and a half years Dunlap sold Scott's remaining core business, the consumer packaging business, to competitor Kimberly Clark at three times Scott's market capitalization at the time he took charge ($9 billion compared with $3 billion). The financial community applauded Dunlap's efforts and pointed to Scott Paper's approach to change as a model to be emulated by others. Dunlap total compensation was more than $100 million, and many of the company's shareholders, including the senior executives he had fired, became much wealthier. However, a proud company ceased to exist. According to informal reports, Kimberly Clark's management was surprised by the condition of the company it had acquired. Scott Paper's many tangible assets were there, but its organizational capability and human assets had been depleted.

Theory O historically has been represented by academics and professional consultants in the field of OD (Beckhard, 1969; Beer, 1980;

Bennis, 1969; Burke, 1982; French & Bell, 1978). Commitment, coordination (teamwork), competence (particularly leadership skills), communication, creativity, and the capacity of employees to engage in constructive conflict must be developed if an organization is to achieve sustained high performance. The way to do this is through high involvement in the change process itself. Theory E change strategies are thought by O advocates to be inadequate if not destructive: They increase self-interest and thereby reduce trust, employee commitment, teamwork, and the capacity to learn (Senge, 2000). Consider the following example (adapted from Ault, Walton, & Childers, 1998; Beer & Weber, 2000):

> Champion International, a company also operating since 1893 in the forest product and paper industry, embarked on a journey of organization change in the early 1980s. Like Scott Paper, it found competing in an industry with frequent cycles of undercapacity and overcapacity extremely challenging. The company had operated for many years as a functional and hierarchical organization and had poor relations with its unions. Its shareholder returns lagged the average for companies in the Fortune 500 and its peers in the industry. CEO Andrew Sigler had resisted the revolution in capital markets that demanded that underperforming companies improve shareholder returns by restructuring.
>
> The transformation journey began with the articulation of a new set of values by Sigler, but he did not drive organization change from the top, despite the autocratic management style he had exhibited over the years. Instead, organization change began with low-profile changes at the periphery of the company. A new manufacturing plant was designed around principles of cross-functional self-managed teams organized along horizontal processes. With the help of a few sociotechnical consultants, managers and employees were involved in the design of the plant. This experiment led to similar change efforts in an ever-larger circles of new and old manufacturing facilities. Over more than a decade, change that started at the periphery spread to the corporate center. What had been at one time a deeply functional corporation evolved into a matrix structure organized around product groups. All corporate functional activities were oriented through the matrix toward product and market businesses and customers. Few financial incentives were used to move change, and no reengineering efforts or layoffs were implemented, although key plant and functional managers who did not adhere to the new philosophy of management were asked to leave.
>
> The transformation was remarkable. Productivity, union-management relationships, and customer and employee satisfaction all improved. A long march, facilitated by a small number of OD consultants in cooperation with the human resource function, had succeeded in managing a change in culture and operating performance, particularly productivity and customer satisfaction. But these changes did not improve Champion's return to shareholders. In 1997 Sigler's successor stated that shareholder returns had to be the objective going forward. Two years later the company was sold at only one and a half times its market capitalization in 1981, when the long journey of change began.

Although most corporate transformations are not pure types, a close examination of these cases and others like them reveals important differences in assumptions about the purpose of business organizations, the motivation of people, and the best means for creating change in bureaucratic, underperforming organizations. These differences are summarized in Table 22.1 (Beer & Nohria, 2000a, 2000b).

Purpose

The purpose of Theory E transformations is to produce economic value, what is commonly called shareholder value.[1] Advocates of this theory believe companies fail because top management has not been an agent of the shareholder. What are needed are monetary incentives tied to shareholder return objectives that will motivate tough decisions about employees and businesses with whom managers have had a long-term relationship. A single-minded focus

Table 22.1 Theories E and O of Change

Purpose and Means	*Theory E*	*Theory O*
Purpose	Maximize economic value.	Develop organization capabilities.
Leadership	Top down.	Participative.
Focus	Strategy, structure, and systems.	Culture.
Process	Plan and establish programs.	Experiment and evolve.
Motivation	Motivate through financial incentives.	Motivate through commitment. Use pay as fair exchange.
Consultants	Large, knowledge driven.	Small, process driven.

on economic value is preferable to a multiple-stakeholder perspective because managers are unable to make quantifiable tradeoff decisions (Jensen, 2000). According to this theory, the marketplace ultimately will help managers attend to the development of the organization's capabilities if this is needed to enhance economic value. For example, if firm performance is hurt by low employee commitment and high turnover, managers will correct their change strategy to incorporate Theory O considerations (Jensen, 2000).

The effort of Al "Chainsaw" Dunlap to transform Scott Paper, described earlier, is arguably the best example of a pure Theory E corporate change effort. Dunlap was single minded in his objective of improving shareholder value, as exemplified by a speech in which he said, "Shareholders are the number one constituency. Show me an annual report that lists six or seven constituencies, and I'll show you a mismanaged company" (Beer & Nohria, 2000b, p. 135).

Theory E is the dominant approach to corporate transformations in the United States. For example, General Dynamics in the 1980s followed this model, as did General Electric in CEO Welch's first 6 years (Heskett, 1999; Murphy & Dial, 1993). Indeed, it is almost standard procedure for new CEOs to launch their change effort with restructuring: the sale of unrelated businesses, closure of underused facilities, and often huge layoffs. E strategies are now making their way to other countries, notably Japan and Europe, where societal values and practices have resisted them until now.

The argument for E strategies is that managers in many organizations, perhaps most, seek to enhance their power base, careers, rewards, and comfort at the expense of shareholders (Jensen, 2000). Recent revelations about how senior executives at Tyco accumulated money and privilege illustrate this. Interestingly, Theory O advocates largely agree with this perspective, although they typically point to the effect on employee commitment and organization learning, not shareholder value (Argyris & Schön, 1993; Deming, 1986; Senge, 2000). There is also evidence that managers, like all human beings, are defensive and therefore discourage open feedback about their own behavior (Argyris, 1990; Beer & Eisenstat, 2000b; Morrison & Milliken, 2000). This causes them to resist reform even when financial returns decline. It is this phenomenon, according to E theorists, that makes a strong market for corporate control essential. And it is the increasing power of this market that has led to E leadership and change approaches such as those exhibited by CEO Dunlap in the Scott Paper case. The results at Scott Paper and many other companies suggest that a single-minded focus on economic value creation quickly corrects excesses created by mismanagement and leads to lower cost, improved

cash flows, and, at least in the short run, higher stock prices (Wruck, 2000). However, there is little evidence that downsizing and restructuring create long-term economic value (Cascio, 1993).

Theory O transformations are based on the assumption that the purpose of a corporation is to serve multiple stakeholders: shareholders, employees, customers, and community. By developing commitment of all stakeholders, particularly employees, the organization, it is thought, will achieve sustained performance. High commitment will cause everyone to work together collaboratively for the survival of the institution (Beer, Spector, Lawrence, Mills, & Walton, 1985; O'Reilly & Pfeffer, 2000; Pfeffer, 1998).

The change effort at Champion International is a nearly pure example of a Theory O transformation and could not be more different from the change strategy at Scott Paper. Although he acknowledged the importance of shareholder value, CEO Andrew Sigler thought that it could be achieved best by focusing on the transformation of organization behavior. In 1981 these goals were articulated clearly in a statement of values. These served as a broad vision and provided a roadmap for a diverse set of change initiatives over a 15-year period. Sigler believed that if the company focused on improving communication, coordination, conflict management, and a culture that encouraged creativity, learning, productivity, and performance would follow. Indeed, the bottom line did improve, but share price in relation to Champion's peers in the industry did not. The improvements were hampered by Sigler's reluctance to sell a number of businesses that did not fit the strategy, an example of how commitment to businesses, people, and communities can blind managers to necessary business decisions. Because of pressures from powerful capital markets, pure Theory O transformations are rare.

Theory O proponents argue persuasively that the human side of enterprise is essential to sustained high performance. Numerous studies do indeed illustrate that participative and high-involvement work systems and cultures lead to extraordinary employee commitment, financial performance, and shareholder returns (Becker & Huslid, 1998; Denison, 1990; Gittel, 2003; Heskett, Sasser, & Schlesinger, 2003; Huslid, 1995; O'Reilly & Pfeffer, 2000; Pfeffer, 1998). Moreover, O theorists argue that because business and organization problems are nonlinear, circular, and recursive, learning should be the single-minded focus of transformation leaders (Argyris & Schön, 1993; Senge, 2000). In this way managers can overcome their inability to predict the future and the unintended consequences of their actions. And there is substantial evidence that to foster such a learning and decision-making process, organizations need to develop commitment and collaboration, characteristics that can easily be destroyed by E strategies (Miller & Lee, 2001).

Leadershsip

Al Dunlap's leadership at Scott Paper exemplifies how most outsiders typically go about implementing an E transformation. Dunlap set financial objective at the top. He ordered restructuring initiatives without involvement of Scott's key executives. Theory E leaders favor top-down change because of their need to show results quickly. "I have a [profit] goal of $176 million this year, and there is no time to involve others or develop organizational capability," explained one Theory E CEO (Beer & Nohria, 2000b. p. 136). Khurana (2002b) has shown that boards of directors bring in outsiders to manage top-down change because they believe that internal candidates are too close to past decisions and to executives they may need to replace. The reason for bringing in a new CEO, a director observed, was his "brilliance and that he would not waste time getting consensus" (Khurana, 2002a, p. 174). The prevailing theory appears to be that charismatic leaders who advocate a new direction and the solutions needed to move there are essential for a corporate transformation (Khurana, 2002a).

The sharp reduction in the length of CEO tenure mentioned earlier suggests that insiders do have difficulty making tough decisions. New CEOs brought in from the outside do not need to defend the past and are motivated to put a new stamp on the organization. Fundamental strategic change is indeed carried out by new managers, research suggests (Grinyer, Mayes, & McKiernan, 1990; Virany, Tushman, & Romanelli, 1992). They are able to maintain the psychological distance needed to make hard people decisions.[2] Theory E leaders may also prefer top-down change out of fear that if they engaged their employees, they would be talked out of needed changes. Indeed, Vroom, Jago, and Arthur (1988) have shown that for participation to be the right choice, employee support for the goals of the enterprise is essential. Support for painful restructuring is not common in failing companies. Conger (2000) argues for top-down change based on the unique perspective that a position at the top offers leaders. He also argues that the "romance of leadership"—the willingness and perhaps need of employees to attribute change to visible and heroic leaders—gives top-down leadership a unique advantage in managing change. Perhaps the most persuasive argument for top-down leadership is that there are almost no examples of slow and participative change efforts that lead to rapid organization transformations.

As the Champion case illustrates, Theory O transformational leaders have distinctly different assumptions. They assume that there is valuable knowledge in the organization about the problems that have blocked performance. Therefore, the best way to solve these problems is to engage key people in an open dialogue about problems and potential solutions. This approach is based on optimistic assumptions about human nature. People want to do a good job, know what blocks needed transformation, and are motivated to improve things as long as they are properly engaged. The central assumption of OD practitioners is that if the difficulty in getting people to speak up honestly can be overcome, barriers to change can be identified and overcome (Argyris & Schön, 1993; Beer & Eisenstat, 2000b). Low performance is a function mostly of the system in which people are embedded, not of incompetence or lack of individual motivation (Deming, 1986).

Just as there is evidence that top-down leadership is needed to overcome resistance and achieve speed, many studies of organization change have illustrated the power of participation in work and change, although this approach works only when there is some level of trust and support for organization goals (Bennis, 2000; Coch & French, 1948; Miner, 2002). Without involvement, Theory O advocates argue, there can be no emotional commitment and true learning. Top-down changes result in compliance, not internalization of new attitudes and skills. Collins (2001) found that successful transformational leaders were humble about their role in the transformation, involved their people in the transformation, and gave them credit for it. Vroom et al. (1988) have shown that participative management is the right choice when developing commitment and competence is the goal. The result of such involvement is partnership and commitment. That is what happened at Champion International. Union leaders and members became partners in the change process, and this enabled the development of competence and commitment.

Focus

E transformations begin with changes in strategy (including changes in the portfolio of businesses), structure, processes, and systems—the "hardware" of the organization. At the core of corporate failures is a strategy that is not working or a bureaucratic organization that is unresponsive; E advocates argue. Dunlap sold some businesses and decided to eliminate a costly and unresponsive bureaucracy by outsourcing many of Scott Paper's services: benefits and payroll, information systems, medical services, and even some of its product research. Aside from the inherent validity of this argument, top management's focus on the harder as opposed to the softer aspects of organizations can be attributed to their personality. Most top executives are "Ts," for "thinking," on the Myers–Briggs Type Indicator. That style favors decisions based on critical analysis of objective facts as opposed to emotions with regard to community, relationships, and fairness, except for relationships that promise personal benefits (Hirsh & Kummerow, 1988).[3] Pressure from capital markets only exacerbates this tendency.

A focus on strategy, structure, and systems is supported by decades of organization research. These studies show that corporate performance is contingent on fit or alignment between a firm's business environment and its strategy and structure (Burns & Stalker, 1961; Chandler, 1962; Collins, 2001; Galbraith, 1978, 2000; Lawrence & Lorsch, 1967). Consider the transformation of IBM under Louis Gerstner. To move the company from a product orientation to a solution orientation, he had to create a matrix structure and supporting systems. These shifted accountability for profit and decision rights from product division and country heads to worldwide customer segment heads (Gerstner, 2003).

Theory O transformations focus on developing a culture that will foster commitment. Its supporters argue that such a culture is a source of sustained competitive advantage because culture, painstakingly developed over many years, is very hard for competitors to imitate (Barney, 1986). The assumption is that poor performance is attributable to alienation and low commitment brought about by top-down control (Pfeffer, 1998; Walton, 1985).

Although successful O transformations incorporate changes in strategy, structure, and systems, these changes occur late in the transformation process and with participation of employees (Beer, Eisenstat, & Spector, 1990a). Champion International changed the nature of jobs and redesigned its manufacturing plant and corporate organizations, but it did so only after a high-involvement process fashioned after the sociotechnical theories and methods of Eric Trist (1969). By starting with shared values and high involvement, Champion International's management was able to reorient attitudes and behavior toward collaboration and teamwork. By involving people in an honest reexamination of business and management practices, the company's leaders were able to reduce skepticism and build trust. Because management encouraged truth to speak to power and responded accordingly, employees became convinced that management meant what they said.

A substantial body of knowledge supports Theory O's focus on culture. Numerous studies have shown that cultures, particularly high-commitment cultures, are associated with high performance (Collins & Porras, 1992; Denison, 1990; Kotter & Heskett, 1992). Hewlett-Packard (until 1999), SAS Institute, Southwest Airlines, and New United Manufacturing, a joint venture of General Motors and Toyota, are frequently cited examples (O'Reilly & Pfeffer, 2000). There is also substantial evidence that companies' fortunes decline if corporate culture and leadership are not transformed as the corporation grows or confronts new business realities (Miller, 1990; Schein 2003). Although it is difficult, there is evidence that corporate culture can be changed and that these changes lead to performance improvements (Beer et al., 1990a; Collins, 2001; Denison, 1990).

Process

Theory E executives launch top-down initiatives with the help of corporate staff groups and consultants to change the corporation. These programs are part of a "battle plan" by the CEO to force rapid change in the organization. This is typically done through standardized education and internal

champions or external consultants who guide local leaders through the changes. If local leaders do not conform, they are moved out. At Scott Paper goals were set at the top, and managers were asked to achieve them by a given target date. Reengineering was mandated and systematically applied in every part of the company.

In following this programmatic approach, Theory E leaders assume that they cannot rely on subunit leaders to implement radical change. Programs are intended to change people's minds about the right way to work and manage. It is hoped that if they change minds, hearts will follow. Given the need for speed, this approach makes sense. It is unlikely that managers below the top who have been embedded in one set of practices will have the attitudes and skills needed to create and adopt a wholly different set of practices in their subunits. And Adler (1993) has shown that centrally established practices introduced through training can improve performance as long as it is done with concern for employees and they are involved in applying the new practices to their own situation. There is also evidence that centrally planned programs can create sustained change in subunits of the larger corporation when the unit's leadership team sees the program as instrumental to their objectives and the local culture is aligned with the program's purpose and substance (Beer et al., 1990a; Edmondson & Woolley, 2003).

Compared with E transformations, O transformations are more evolutionary and emergent. They start with the premise that large corporations cannot be changed at once or with the same top-down prescriptions; one size does not fit all. Organization change is treated as a process of experimentation beginning with a small number of units followed by adoption in many other units (Beer et al., 1990a). Innovation in one part of the organization can lead to learning in other parts if properly encouraged by top management (Walton, 1977). There was no master plan at Champion when the transformation started in 1981. Innovations in work systems, union–management collaboration, and worker involvement began in a new "green field" manufacturing plant and spread from there, first to other new startups and later to older plants with more entrenched cultures. No single manager or function was seen as the central driver of change, not even CEO Sigler. Local unit managers and their people took responsibility for change, supported by a small cadre of internal and external consultants. Consistent with research on corporate renewal, innovations in organizing and managing at Champion spread from early adopters to other units (Beer et al., 1990a; Walton, 1987). Top management's role is to encourage the dissemination of innovation. They do it by supporting leading unit managers politically, orchestrating conferences where managers are exposed to the innovations, arranging for visits to innovative units, and promoting managers in leading units to run lagging units. This process is much slower. Champion's transformation took 15 years, compared to 2½ in the case of Scott Paper's E strategy.

The wisdom of slower and emergent corporate transformations is supported by evidence that top-down programs do not fundamentally transform large corporations (Beer, Eisenstat, & Spector, 1990b; Miller, Hartwick, & LeBreton-Miller, 2004; Shaffer, 1988). There are several reasons for this. In diversified multibusiness organizations the same management practice may not apply to all businesses. Even when the task across all subunits is the same (e.g., retail stores, manufacturing plants) and the content of the program is relevant, leaders of subunits comply but are not committed. This means that they will not engage their organization in an active learning process that adapts the programmatic solution to their particular circumstances (Beer, 2003; Beer et al., 1990b; Edmondson & Woolley, 2003).

There is also a developmental cost to top-down programs. Because centrally driven programs put subunit leaders in compliance mode, they do not learn how to lead change—mobilizing people in a common effort to identify, diagnose, and solve problems—a capability essential for long-term corporate success. At the same time, research shows that when managed effectively, transformations that follow the slower and emergent unit-by-unit strategy produce dramatic change in corporate culture, effectiveness, and performance (Beer et al., 1990a; Beer & Weber, 1997). Procter and Gamble used a slower unit-by-unit transformation strategy to gain a 40% cost advantage over its competitors in the 1970s, one that its competitors did not quickly replicate. Although they take longer, unit-by-unit strategies change minds *and* hearts and promise to lead to a high-commitment organization capable of sustained high performance (Beer, 2001).

Motivation

E transformations use monetary incentives such as bonuses and stock option plans as a prominent lead intervention. The first thing Dunlap did at Scott Paper was to introduce such incentives. Ultimately these incentives paid out large sums of money to many executives. Dunlap's compensation ultimately rewarded him with $100 million as a result of the increase in the price of Scott Paper stock. The assumption underlying the heavy early use of incentives linked to shareholder interests is that money will motivate managers to make quick, tough decisions. Pay-for-performance incentive systems, their proponents believe, will unfreeze and refocus existing behavior quickly because they are highly visible, tied to relevant performance outcomes, and substantial (Lawler, 2000). A second purpose for these pay system changes is to create larger differences in compensation between better and poorer performers and thereby to undermine the entitlement cultures that often reside in underperforming companies (Baker, 1993).

Much evidence supports the claims that financial incentives are desired by employees and lead to changes in behavior and performance. Employees believe that pay-for-performance systems are fair because they promise to differentiate between better and poorer performers (Beer & Gery, 1972). A meta-analysis of pay-for-performance studies found that performance improved in approximately two out of three pay-for-performance program introductions (Heneman, Gresham, & Ledford, 2000). Gibson (1995) reports on a study by Carla O'Dell and Jerry McAdams (sponsored by World at Work and conducted by the Consortium for Alternative Reward Strategies) that suggested that the average net return on money invested in pay-for-performance programs was an impressive 134%. Surveys of 500 companies reported in *The Economist* ("Business: Pay Purview," 1998) indicated that those actively using pay-for-performance programs showed twice the shareholder returns as those who were not actively using these programs. Lincoln Electric, for many years a high-performing Midwest manufacturing firm, demonstrated that variable pay, linked to measurable individual performance outcomes, improves quality and productivity, although an important aspect of their success, not always well understood, was the culture of cooperation in which the incentive system was embedded. Incentive payouts were contingent on an evaluation of the employee's cooperativeness.

However, the case for incentives is undermined by findings that monetary incentive systems have a positive effect initially but may ultimately be undermined by contextual factors beyond the control of the individual or group. These weaken the link between effort and the performance and make it hard to justify incentive payouts (Beer & Cannon, 2004; Lawler, 1971, 1981). When employees lose control of the factors affecting their performance, the perception that the compensation system is fair and that management can be trusted is undermined. To satisfy the requirements for fairness, incentive systems typically are redesigned frequently, raising their costs in

time, money, and loss of trust and commitment, leading Theory O proponents to argue that the costs of these systems outweigh their benefits (Beer & Cannon, 2004; Beer & Katz, 2003; Lawler, 2000). In one high-commitment organization employees gave management a party when they discontinued a team-based incentive system (Beer & Cannon, 2004). Moreover, there is evidence that incentives can undermine teamwork and cause managers to manipulate goals, particularly when the incentives are focused on individual or individual unit performance (Beer & Katz, 2003; Hambrick & Siegel, 1997). They can also cause managers to focus narrowly on the goals to which the incentives are tied.

O transformations motivate primarily through the creation of meaning, involvement in the task, and participation in decisions. Pay is used to recognize effective behavior and performance and is far less central to motivation. Differences between top management and lower levels with respect to rewards such as offices, status symbols, and total compensation are minimized. At Champion International a skill-based reward system was used to encourage and reinforce the acquisition of new skills. A corporate profit-sharing plan applied equally at all levels was used to reinforce teamwork across the company and between management and production workers. Although executives at Champion received stock options and bonuses, they represented a smaller percentage of total compensation than a similar compensation system at Scott Paper.

Theory O assumptions about motivation are supported by evidence that financial rewards typically are ranked well below needs for meaningful work and good supervision (Beer et al., 1985). Evidence also shows that the nature of work itself motivates (Hackman & Oldham, 1980). Jobs that are perceived as significant and provide autonomy and feedback will involve and motivate people who value autonomy, achievement, and growth. Such a work setting may also develop these needs, thereby developing a more motivation-ready workforce. An extensive review of the literature on high-involvement and high-performance work practices by Pfeffer (1998) shows that when people are given the freedom to make a difference in the context of extensive training, employment security, and comparatively high compensation contingent on organizational, not individual, performance, then productivity, quality, service, and organization performance improve.

Consultants

Theory E change strategies often rely heavily on external consultants. Large consulting firms with armies of experts are brought in to analyze the market and the company and suggest changes in strategy and organization. Most of these firms also offer help in implementing change. Consultants lead employee project teams in solving problems and formulating recommendations. In 1997 AT&T was reported to have spent $200 million on such expert services. Consultants were used by Dunlap to identify and manage cost-saving initiatives.

Large-scale consulting engagements make sense in a crisis (Miles, 2000). Capital markets demand rapid change. An infusion of experts will move change along rapidly. CEOs may not always be able to reframe strategic and organizational problems without the help of outsiders. Consultants also offer specialized talent that may not be available in the company, and they may offer psychological and political support to turnaround CEOs who do not trust their own managers to be objective. Finally, consultants may enable CEOs to legitimize their turnaround strategy with the board of directors.

Theory O transformations rely on a far smaller set of external process consultants to help managers identify, analyze, and solve problems themselves. At Champion, a very small number of these consultants were introduced early in the transformation and continued to be

involved throughout the 15-year period. They came with Theory O tools and frameworks to facilitate the process of change.

Two arguments can be made for the process consulting approach (Schaffer, 2000). The first has to do with the problems created when outside experts enter a firm to offer advice, and the second has to do with the benefits of process consultation. The infusion of an army of experts may result in precise and well-crafted solutions but takes away ownership and learning opportunities for managers. Managers may comply for political reasons but avoid confronting deep organization and leadership problems that block implementation of recommended solutions (Beer & Eisenstat, 2000b; Schaffer, 2002).

Even if immediate implementation were not a problem, managers may grow dependent on consultants, particularly if they stay involved over a long time. One of the main problems with large-scale consultant interventions is that the firm and its managers may be prevented from developing the most critical capability they need: the capacity to lead a learning and change process (Miles, 2000). Solutions offered by consultants may also make it easier for managers to avoid confronting deeply rooted organization and leadership problems. Process consultation, on the other hand, enables such learning (Schein, 1969). The approach is very effective in creating cultural change but is slower, as the Champion case illustrates. It also may not challenge management sufficiently to reconsider hard economic and strategic realities. In the case of Champion senior management was not challenged by the Theory O process consultants to restructure the portfolio of businesses.

EMBRACING THE PARADOX OF E AND O

This discussion suggests that E and O strategies each have great strengths and equally great limitations. Therefore, the paradox of E and O must be embraced to obtain the benefits of both theories. But unless this is done carefully, integrating these theories is likely to yield the worst of both worlds. A typical failed approach to embracing the paradox is to compensate for E strategies that reduce commitment, trust, and teamwork by introducing top-down human resource management programs. As suggested earlier, these programs foster cynicism when no real change occurs, and they fail to engage unit managers at every level in leading a genuine transformation in their subunit (Beer et al., 1990a, 1990b).

The easiest way to combine these strategies effectively is to begin with Theory E and follow with O. At General Electric Jack Welch began the transformation by restructuring the company between 1981 and 1985. Businesses were told they had to be number one or two in their markets or they would be sold or closed. He also downsized the organization radically, reducing employment from 412,000 to 299,000. Sixty percent of staff groups were laid off. In this phase Welch became known as "Neutron Jack." However, he followed with Theory O strategies. With the help of OD consultants he began to launch a series of OD initiatives in 1986 to change the culture. Criteria for promotion were changed, and Welch introduced and institutionalized a rigorous review of key people known as "section C reviews." To be promoted managers had to produce financial results and also demonstrate that their managerial behavior was consistent with GE's Theory O values. Managers at all levels also had to go through a rigorous process called "Workout," which required them to be confronted by their own employees with feedback about barriers to their organization's effectiveness (Tichy & Sherman, 1993). In the last decade of his tenure, Welch spent 50% of his time on people and their development. However, sequencing works only when O strategies follow E strategies, not the other way around. If E follows O, it is highly likely that employees will feel betrayed. Draconian E

initiatives would shatter the psychological contract built over many years by a participative O strategy.

The sequencing approach takes too long, however. Welch was fortunate to have 20 years at the helm of GE. Because most CEOs' tenure is far shorter, they must implement E and O strategies simultaneously and in an integrated manner. This will prove difficult for many turnaround managers. Temperamentally they find it difficult to embrace theory O, and their E strategies earn them distrust not easily overcome. Welch was an exception.

The solution is a diverse yet effective senior management team with a range of E and O perspectives. Consider the highly successful transformation of Asda, a UK grocery chain, led by a pair of managers, one with an E orientation and skills and the other with an O orientation and skills (adapted from Beer & Weber, 1997).

> When Archie Norman took charge of British grocery chain Asda in December 1991, the company was 1.5 billion pounds in debt and near bankruptcy. Asda, like Scott Paper and Champion International, had a long and venerable past. It had sprung from a dairy farmers' association into one of Britain's leading grocery chains. It was the first to build superstores and one of the most successful in broadening its offerings to include clothing and other nonfood items. Although Asda offered value and therefore had lower profit margins than its high-end competitors, it had been consistently profitable. However, because of overcapacity in the industry, Asda experienced intense pressures on margins, and it experienced the slow growth characteristic of the industry, although it continued to be the grocer of choice for working-class shoppers looking for value. In the 1980s, in an effort to improve margins and grow the business more rapidly, management began to raise prices and acquire a number of nongrocery retail businesses. By borrowing money to purchase 60 stores instead of capitalizing the purchase, management caused the company to incur an unsustainable debt burden when interest rates increased in the inflationary environment of the late 1980s. Top management's autocratic management style prevented store managers from confronting management with their views that these policies were potentially disastrous. When Norman arrived, he found a hierarchical and bureaucratic organization running out of cash. Store managers felt they had no influence on a trading (purchasing) group at headquarters that was buying high-end products Asda's working-class customers did not want to buy. Morale was extremely low, and the company was running out of cash.
>
> Norman quickly moved to stem off bankruptcy. He fired the chief financial officer within hours of his arrival, stopped all capital expenditures, sold unrelated businesses and unprofitable stores, imposed a wage freeze, and laid off 10% of the workforce. Declaring to the financial community that it would take 3 years to see results, Norman visited stores in the first 2 weeks to talk with and listen to employees and store managers. He immediately reconfigured his top team by removing a layer of management and recruited two new senior executives. One of them, Allen Leighton, soon to become an equal partner in leading change, complemented Norman's strategic and intellectual capabilities with his down-to-earth style and personal leadership skills.
>
> During the restructuring initiatives, Norman articulated a back-to-roots strategy and Theory O values that would govern the business in the years ahead. He authorized radical experimentation in one and then two other "renewal" stores and declared them "risk-free zones." These store managers would not be held accountable for short-term financial results, as other store managers were. A cross-functional task force was commissioned to work with store management reinventing the concept of an Asda store—its design, retail proposition, and approach to organizing and managing people. This began a renewal strategy that ultimately transformed most of Asda's 200 stores over 8 years. During this period a variety of improvement teams and task forces were institutionalized.

> Throughout, Norman and Leighton spent enormous amounts of time in conversations with various groups of employees in the company, articulating their strategic goals and values, surfacing barriers to progress, and engaging people in developing solutions. During 8 years of change more than 50% of managers who were unable to adopt the Asda way of managing were replaced. According to Norman, 75% of his time in the first 3 years was spent on human resource and organization development issues.
>
> Asda's financial performance turned around by 1994 and was followed by a long string of quarters in which it outperformed the industry in like-for-like sales improvement. The company soon began to be regarded as a leader in the retail industry, with profits and share price improving steadily. The culture was transformed from a hierarchical, bureaucratic organization with low morale to one in which employees and customers were being heard through a variety of institutionalized mechanisms for two-way dialogue. Asda developed the organization capabilities of coordination, commitment, competence, creativity, communication, and the ability to manage conflict in a productive way typically found in companies with sustainable competitive advantage.
>
> In 1999 Asda was sold to Wal-Mart, a high-performing company with many of these capabilities, at eight times its market capitalization at the time Norman took charge. Wal-Mart managers were quoted as saying, "Asda is more like Wal-Mart than Wal-Mart is like Wal-Mart." Norman had successfully led a financial *and* cultural transformation that Wal-Mart executives recognized as the source of sustained performance.

Asda's successful transformation illustrates the means by which a leadership team with both Theory E and O perspectives can create an integrated strategy for change. Table 22.2 articulates the paradoxical combination in Asda's transformation. Change was led from the top through advocacy of a new business direction and also a new organization direction. Like Scott Paper, Asda was restructured (though with a very different style), but as at Champion, a hierarchical culture was transformed to an open, egalitarian, and participative one. Top management created a broad plan for change at the top, but it enabled spontaneous innovation at the store level through radical store-level experimentation from which a new retail and cultural model emerged, one that Norman had not fully envisioned or planned at the beginning. This store-level innovation is very similar to Champion's experimentation in its manufacturing plants. Although managers received bonuses and stock options based on unit and company performance, Norman insisted that the vision of building a better Asda and high involvement at all levels was the key motivator. Finally, several large consulting firms were brought in for expert analysis and advice early in the transformation journey, but so were process consultants to help managers reinvent stores and managerial practices. In the third year of change Norman and Leighton began to cut back consultant involvement to prevent managers from becoming dependent on them.

The fact that Wal-Mart bought Asda at eight times the market capitalization of the company when the transformation began 8 years earlier (much more than the three-to-one paid for Scott Paper's E transformation and the one-to-one and a half paid for Champion International's O transformation) suggests that embracing the paradox of E and O yields superior economic returns. All stakeholders in the company benefited from this approach.

What enabled this rare outcome? It was an all too rare partnership between two leaders with different strengths, skills, and perspectives. Norman and Leighton learned from each other, and this enabled them to avoid the law of unintended consequences. All too often one leader and one theory dominate. This prevents the leader from learning about the unintended consequences of his or her dominant theory of change. Because E strategies are top down, they

Table 22.2 Integrating Theories E and O

Dimensions of Change	*Theories E and O Combined*
Purpose	Explicitly embrace the paradox between economic value and organization capability driven change.
Leadership	Set direction from the top and engage the people below.
Focus	Focus simultaneously on the hard (structures and systems) and the soft (corporate culture).
Planning	Plan for spontaneity.
Motivation	Involvement is used to motivate; compensation is used to recognize, not motivate.
Consultants	Consultants are expert resources who empower employees.

create a climate of silence that prevents lower levels from confronting top management with organizational and managerial barriers, particularly top management's own leadership behavior and policies (Beer & Eisenstat, 2000b; Morrison & Milliken, 2000). The unintended consequences of an O strategy, failures to confront hard strategic and business realities, are equally difficult to confront, short of pressure from capital markets that remove the O leader. Values that hold dear people, process, participation, and purpose are defended without regard to economic reality.

PRINCIPLES FOR EMBRACING THE CONTRADICTION OF THEORIES E AND O

Simply describing and urging the integration of E and O will not cause leaders to embrace the paradox of E and O. Leaders' past experience, values, and skills and their business and social context predispose them to lead with their dominant E or O assumptions. Managers in Japan, until very recently at least, have eschewed theory E because of strong societal values and traditions that favor the community over immediate economic outcomes. The results have been a disastrous 13 years of recession and underperformance. In the United States, and to a somewhat lesser extent in the United Kingdom, CEOs lean strongly toward Theory E. However, an integrated E and O transformation is possible if leaders motivated to embrace the paradox can learn about the unintended consequences of their E or O assumptions and decisions. GE's Jack Welch did. He began to embrace Theory O after the limitations of his sole focus on an E strategy began to be apparent. Unfortunately, most organizations are programmed to prevent truthful discussions about the unintended consequences of their leader's change strategy (Argyris & Schön, 1993; Beer & Eisenstat, 2000b).

What is needed is a socially engineered leadership platform—a guided process for strategic leadership and change—that embraces and integrates the tensions between E and O. For leadership teams who do not have the perspectives or capacity to embrace a paradoxical strategic leadership stance (most, in our experience) such a leadership platform would specify the paradoxical change process leaders must follow if they are to achieve both strategic business and OD objectives. For the past 15 years Russell Eisenstat and I have worked to develop such a paradoxical leadership process. It enables a senior team to engage organization (O) issues in the context of strategic business (E) issues (Beer & Eisenstat, 2000b, 2004; Eisenstat & Beer, 1997). The Strategic Fitness Process (SFP) orchestrates a multilevel organization-wide

public conversation (see Figure 22.1 for the key steps). The process falls into the genre of OD interventions, called large group or system-level interventions, that enable leaders to engage their organizations in honest conversations about potentially sensitive strategic, organizational, and management issues (Beckhard, 1967; Bunker & Alban, 1997; Ulrich, Kerr, & Ashkenas, 2002; Weisbord, 1991). Unlike these OD interventions, however, SFP is explicitly designed to create an integrated E and O transformation agenda. It departs from other organization-wide interventions by putting business strategy and gaps in business performance at the center of the change process.

The process begins with the top team (corporate or business unit) advocating E and O objectives and articulating these in a two- to three-page statement of business and organization direction. It then guides the senior team to inquire into organization realities that potentially block their E and O objectives through an inquiry carried out by a task force of eight of their best and highest potential managers, managers they will believe when they present their findings. This is done through interviews with 100 key people in the organization by the task force. Interviewees are asked to describe the organization's strengths and barriers to achieving top management's business and organization direction. A structured feedback process that has emerged from years of experimentation enables the senior team to learn the unvarnished truth about E and O issues. A central premise of this feedback process is that the only way truth can speak to power is if the task force can speak as a group and can validly claim to be speaking as reporters rather than as themselves. This is accomplished by asking the task force to discuss key themes in a "fishbowl," with the

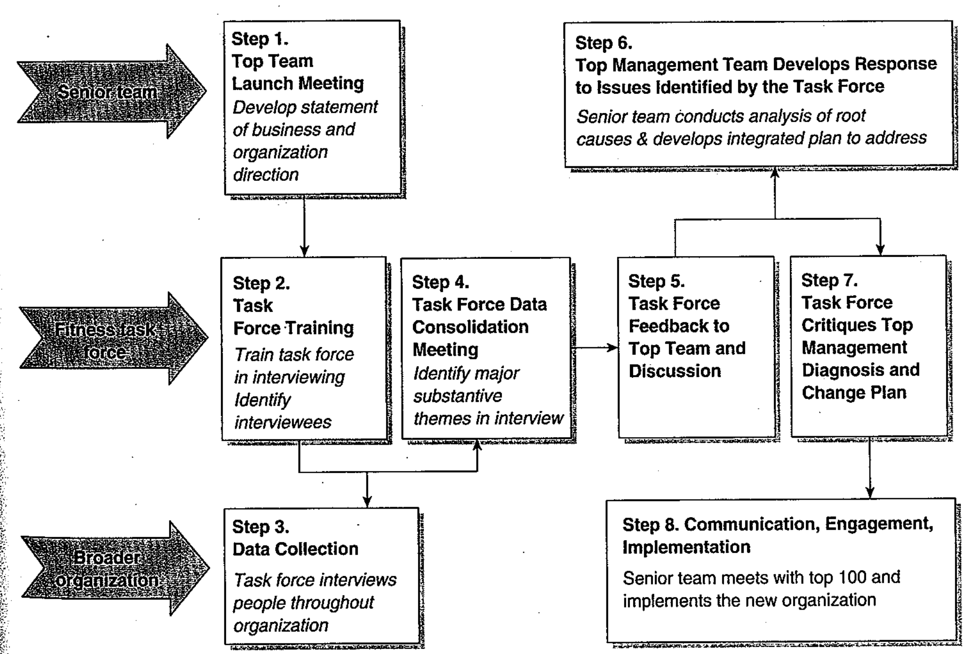

Figure 22.1 The Strategic Fitness Process: A Way to Have an Honest Conversation That Integrates Theories E and O

senior team seated around them, listening and taking notes, all in the context of explicit ground rules for dialogue (Beer & Eisenstat, 2000a; Eisenstat & Beer, 2002).

Feedback is followed by a systemic E and O diagnosis and an integrated action plan that addresses root causes. A number of analytic frameworks aid analysis of the fit between business strategy and the organization and present the senior team with the design and policy choices they face. In this way the hard substantive issues are integrated into the equally important soft cultural and commitment issues inherent in organization transformations. The learning loop continues when the senior team presents its change plan to the task force and receives a critique to which they must respond. Organization change is launched at a meeting at which the senior team and the task force communicate to the 100 key people interviewed—the dominant coalition—the outcomes of the process and how implementation will be carried forward and with whose involvement. Top teams meet with the task force once a quarter to review progress in change, and the full process is recycled once a year as part of the business planning process.

A decade of implementing and researching SFP has led us to extract a set of operating principles for implementing an integrated E and O transformation (Beer & Eisenstat, 2004). In this section I describe these principles briefly and explain what we have learned from implementing SFP in more than 200 organizations in 35 companies at the corporate and business unit level in the United States, Asia, Latin America, and Europe.

Demand a Lot and Give a Lot.[4] To change the behavior and performance of ineffective organizations, leaders must set new standards and demand that managers and workers live up to these new standards. Welch at GE articulated new performance standards ("Your business must be one or two or we will sell or close it"). But for new demands to stir commitment, senior management must also be willing to give away more than economic rewards. It must send clear signals that it is willing to share power and control in the pursuit of excellence. This means giving employees a voice in the transformation and owning up to their own errors. Dunlap at Scott undermined the legitimate economic objectives of his transformation by paying himself $100 million while reducing the workforce by thousands, moving headquarters to his hometown for convenience, wielding absolute power, and verbally abusing employees.

An honest collective and public conversation about barriers to change prompted by SFP and the principles below produced the exact opposite result. An analysis of a dozen SFP applications shows that senior teams gain legitimacy by exposing their E and O objectives to inquiry, accepting honest feedback and responding with a plan for transformation, itself subject to critique. This occurs for three reasons. First the focus on business goals and strategies energizes employees to participate in what they know to be the keys to success and failure of the enterprise. Second, because the senior executives and their team make themselves vulnerable and show a willingness to change their policies and behavior for the good of the organization, hope is raised that change will be more than superficial. Third, engaging in a public inquiry process signals lower levels that the senior team is ready to sacrifice power based on position for power based on knowledge and centrality to successful implementation. Consider what Lynn Camp, vice president and general manager of Agilent Technology's Signal Source Delivery Unit (SGDU) told a "Fitness Task Force" that delivered the unvarnished truth about the state of the organization and consider the impact on commitment to the organization and its objectives:

> You lit a fire under us. Thank you for the unvarnished truth. . . . I take your feedback very seriously; it is my personal appraisal. . . . If the organization is going to change, I must change. The leader at the top casts a shadow. (Beer & Eisenstat, 2004, p. 7)

Embrace the Paradox With a Compelling Articulation of Business and Organization Direction. A failing business needs restructuring and a new business model with tough financial goals if it is to become economically viable (Collins, 2001). It also needs a new organization model and values to transform behavior. Without a redesigned organization, the new business model cannot be implemented. Without values, meaning, and commitment, sustained economic performance cannot be developed (O'Reilly & Pfeffer, 2000). Asda's long-term success can be traced to Norman's balanced E and O direction, articulated to his senior team on his first day. He made "securing value for the shareholder" and the revitalization of values and culture equal priorities. He launched a "renewal program" aimed at completely redefining how a store would be organized and managed on his first day as CEO, when he also announced sweeping restructuring goals and measures.

In almost all the organizations we studied, top teams had not developed an integrated E and O direction. New strategies were not accompanied by a clear idea of how the organization and leadership team had to change to enable implementation of the business strategy. Nor were organization changes solidly tied to economic goals and business strategy. With the help of six core questions, which focused on both E and O, top teams were able to create an integrated E and O direction that could then be challenged by inquiry into organization barriers. In many cases this was the first time the senior team had tried to create an integrated agenda. In all cases they discovered that they as a team did not fully understand the connection between E and O issues. In all cases senior teams and organization members acknowledged that the process of creating the integrated direction had clarified what needed to happen to create a successful transformation.

Underlying this principle and the SFP process is the belief, supported by research, that successful O transformations in culture and behavior must start with a focus on business goals and tasks. Transformations must be equally concerned with "hard" organization design issues and "soft" behavioral issues (Beer et al., 1990a; Collins, 2001). Disconnected from E objectives, O strategies are seen as idealistic and impractical. They lose credibility quickly. The failure of OD as a field to gain traction with senior executives may be traced in part to the fact that its theory and practice have not embraced the paradox of E and O.

Ownership and Active Leadership by a Diverse and Aligned Senior Management Team Are Essential. Transformations succeed only when the senior team embraces the E and O paradox as a team and leads the change in a unified manner (Tushman & O'Reilly, 1997). In too many E transformations leadership of change is delegated to consultants, staff groups, and task forces while senior management's priorities and behavior remain unchanged. To embrace the E and O paradox, top team members must have diverse perspectives: shareholder and employees, finance and human resources, and strategy and culture. Norman's success in embracing E and O at Asda was a function of his ability to build an effective team with diverse views that was deeply involved in leading the transformation as a team. When senior teams are effective in resolving their different perspectives through a fact-based dialogue, they can manage the "and also" so essential for a successful transformation (Beer & Eisenstat, 2000b; Eisenhardt, Kahwajy, & Bourgeois, 1977). All the senior teams that implemented these principles through SFP learned from their task forces that their business goals could not be implemented because they were not functioning as an effective team. Senior teams were perceived as unaligned with regard to strategic direction, priorities, and values. Too much of their time together was being spent on administrative matters and not enough time was being allocated to confronting difficult strategic and organizational issues that threatened the status quo and then leading change in them. Teams that changed the amount of time

and energy they spent in resolving strategic business issues and at the same time the organizational and behavioral issues that prevented alignment were more successful in transforming their organization than those who did not. Consider the following quote from one of the most successful applications of these principles:

> Our top team has taken some big strides in becoming more effective. Scott [the general manager] looks to be taking more control of the reins and becoming the kind of leader the division needs. He and his staff will sit down as a group now and talk strategy where before they would have only talked about administrative detail. (Beer & Rogers, 1999, p. 4)

Enable Truth to Speak to Power. Without enabling lower levels to speak truthfully, leaders insulate themselves from the realities of their organization. They are unable to learn about the unintended consequences of their E or O theories of change. Leaders therefore should structure conversations that provide honest feedback. Welch held frequent no-holds-barred conversations with lower-level managers at GE's corporate education center. This is how he learned that his E strategy—"you have to be number one or two in your market or you will be sold or shut down"—was being undermined. General managers were simply redefining their markets narrowly to avoid being sold or shut down.

In all the organizations where SFP was applied, the inquiry surfaced the unvarnished truth about barriers to E and O goals that had not been in the open before. Confronting the truth energized senior teams to make changes in strategy and organization that promised to align the culture with the business's strategy. The truth about E and O quite often caused top management teams to make changes that were painful: selling a business, prioritizing projects, removing managers who did not conform to the new values, and redesigning the organization to enable teamwork even when it was politically difficult. The truth made managers more accountable to shareholders, customers, and employees than they had been before. Consider the following top team member's view of how truth changed her organization:

> For instance we're now reviewing all the projects and making investment decisions, where before that would happen with one or two people in a side conversation. Those [had bad] ramifications all through our organization. (M. Beer, unpublished source)

Address Business, Organizational, Cultural, and Leadership Issues Holistically and Systemically. E and O theories of change address different but deeply connected sides of the enterprise. That is why a systemic approach to organization transformation is essential if the paradox of E and O is to be embraced (Cummings, 1980). The truth about the organization's capacity to achieve E and O goals, together with a systemic framework to analyze the gap, made it possible for managers who applied SFP to develop and implement an integrated agenda for change. Organization design and culture were transformed to enact strategy, and strategy was modified based on data about the organization's capabilities. New structures, particularly ones that necessitated cross-departmental or business teamwork, were accompanied by changes in the leadership team's role and behavior. And people were replaced or volunteered to leave when their motivation and skills did not match the transformational objectives.

At the Hewlett-Packard Santa Rosa Systems Division a root cause diagnosis, prompted by honest feedback, led to changes in multiple aspects of the system—the strategy, the leader's behavior, the senior team, the organization's structure, the resource allocation process and ultimately the culture (Beer & Rogers, 1999).

Sustain the Transformation Through Disciplined Cycles of Action, Learning, and Reflection. Transformational E and O goals espoused at the top often are not translated into reality at lower levels (Mallinger, 1993; Zbaracki, 1998). The only way to ensure that such a gap does not develop is to view corporate transformations as a continuous learning process. Managers can learn about unintended O consequences of E strategies and unintended E consequences of O strategies. Indeed, it is this principle that enables the organization to reinvent itself—the ultimate source of sustained competitive advantage. Of course, that is why the earlier principle of enabling truth to speak to power is so important. The Hewlett-Packard Santa Rosa Systems Division mentioned earlier used SFP to implement these principles every year for 5 years. Each year they discovered another deeper layer of E and O issues and how they interacted. And this is what enabled them to make an integrated E and O transformation over a 6-year period. Like others who followed these principles, they achieved dramatic changes in their financial performance and organization capabilities. Top management reported that they had risen from the worst division to among the best in the company (Beer & Rogers, 1999).

Apply These Principles in Every Unit of the Corporation From Top to Bottom. If corporate transformations are to incorporate both E and O strategies, top management must encourage, even demand, that unit leaders use the aforementioned principles to engage their organizations in a learning process from which they also learn. Faced with significant business challenges in Latin America, Grey Warner, Merck's senior vice president for Latin America, used the principles outlined earlier to lead successful E and O transformations in each of 10 Latin America country organizations. He did not launch a "one size fits all" solution for all countries in Latin America. Instead he asked each country manager and their top team to use SFP to define their business (E) and organization (O) direction and then use the aforementioned principles to learn about barriers and lead change. He held country managers accountable by meeting with them to review what they had learned about their organizations and their leadership. To help them develop their organization, he supplied corporate resources when needed. Four years later the hierarchical cultures in all 10 organizations had moved significantly toward greater openness and participation, with substantial improvements in financial performance (Beer & Weber, 2001). A decade later a corporate-wide employee survey indicated that the Latin American region was higher than most other Merck organization units on a number of important human and business outcomes.

An analysis of a dozen organizations that used these principles showed that they were successful in surfacing and motivating E and O changes. O transformations occurred in coordination between functions or geographic regions, commitment to the organization, leadership effectiveness, openness of communication, and the capacity to manage conflict constructively. Improvements in financial performance could also be tied to organization changes in a number of cases, although without a control group one can never attribute causality. In one company, following SFP principles led the CEO and his team to spin off a business unit that constituted approximately 40% of the corporation's total revenue after they heard from the fitness task force that there were no synergies, something they suspected but had not acted on. This resulted in a rise in share price, demonstrating that these principles can have an immediate and direct effect on economic value, not just organization development. Fearing the difficulties of breaking up a company with a long history and tradition, the CEO had been putting off making this difficult decision, even in the face of a depressed share price and unenthusiastic stock analyst reports. The SFP principles changed economic value in a way that capital markets did not.

The principles outlined here were not equally successful in all organizations. The CEO or general manager had to be open to learning about his or her theory of transformation. Those who followed the operating principles for change discussed in this chapter were able to craft a transformation that embraced the E and O

paradox. Not surprisingly, leaders in companies that historically had been exclusively E oriented and hierarchical did not embrace the principles as eagerly or easily. However, many that stuck with the principles learned from their experience about the side of the paradox that they were least committed to or skilled in implementing, were most often on the O side.

CONCLUSION

I have argued that only managers who embrace the paradox of Theories E and O can achieve a sustained transformation in economic performance and organization capability. I used three cases to illustrate this thesis. An E transformation at Scott Paper resulted in some significant immediate gains for shareholders but undermined the organization's capabilities. An O transformation at Champion International resulted in a remarkable change of the culture and improvements in a number of operating measures of performance but resulted in negligible changes in shareholder value. Finally, an integrated E and O transformation at Asda led to a fundamental transformation in organization capabilities and economic value. The study by Collins (2001) cited at the beginning of this chapter confirms these conclusions. Eleven companies (out of a possible 1,435) that achieved a sustained transformation did so through an integrated E and O transformation enabled by CEOs willing to confront the brutal facts about business and managerial issues. That only a small set of companies managed to achieve this result suggests that leaders clearly need help in integrating E and O change strategies. This chapter offered seven principles that leaders interested in learning how to integrate E and O might follow. By using these principles to engage their organizations in a strategic learning process, leaders were able to learn from lower levels about their theory of transformation and modify it to embrace the paradox of E and O.

Learning about one's own theory of change and moving to embrace the opposite theory proved difficult and painful for most of the managers in the companies we studied. A structured and carefully designed collective and public learning process (in this case SFP) that embraced the principles provided the essential discipline managers needed to embrace the paradox and learn. It provided guidance where leadership skills or knowledge about strategy and organizations were lacking. It created a mandate for change to which most leaders, who otherwise would avoid painful decisions, had to respond. Not doing so, they immediately recognized, threatened their credibility and legitimacy as leaders, something they instinctively knew they could not afford to do.

NOTES

1. An increase in the value of a company's stock price is not necessarily an indicator of increasing economic value. A stock price rise can be a function of the general movement of the stock market. Economic value is created by growth in profits net of the cost of capital.

2. There is some evidence that unlike most Theory E CEOs, Al Dunlap went beyond creating distance. He seems to have taken some pleasure in treating his key managers badly (Gilson & Cott, 1996).

3. Data from tens of thousands of executives who have taken the Myers–Briggs Type Indicator show that top managers are "thinking" types, who prefer to approach problems through analysis, as opposed to "feeling" types, who make decisions based on concerns about fairness and relationships. They also prefer control over spontaneous behavior (M. Beer, unpublished Myers–Briggs Type Indicator data from some 500 senior executives in Harvard Business School's Advanced Management Program).

4. I am indebted to my colleague Russell Eisenstat for this insight.

REFERENCES

Adler, P. A. (1993, January–February). Time and motion regained. *Harvard Business Review, 71*(1), 97–108.

Argyris, C. (1990). *Overcoming organizational defenses,* Needham Heights, MA: Allyn & Bacon.

Argyris, C., & Schön, D. (1993). *Organizational learning II.* Reading, MA: Addison-Wesley.

Ault, R., Walton, R., & Childers, M. (1998). *What works: A decade of change in Champion International.* San Francisco: Jossey-Bass.

Baker, G., III. (1993, November–December). Perspective: Rethinking rewards. *Harvard Business Review, 71*(6), 37–44.

Barney, J. B. (1986). Organizational culture: Can it be a source of sustained competitive advantage? *Academy of Management Review, 11,* 656–665.

Becker, B. E., & Huslid, M. (1998). High performance work systems and firm performance: A synthesis of research and managerial implications. In R. Ferris (Ed.), *Research in personnel and human resource management* (Vol. 16, pp. 53–101). Greenwich, CT: JAI.

Beckhard, R. (1967, March–April). The confrontation meeting. *Harvard Business Review, 45,* 149–156.

Beckhard, R. (1969). *Organization development: Strategies and models.* Reading, MA: Addison-Wesley.

Beer, M. (1980). *Organization change and development: A systems view.* Santa Monica, CA: Goodyear.

Beer, M. (2001). How to develop an organization capable of sustained high performance: Embrace the drive for results–capability development paradox. *Organizational Dynamics, 29*(4), 233–247.

Beer, M. (2003, Fall). Why total quality management programs do not persist: The role of management quality and implications for leading a TQM transformation. *Decision Sciences, 34*(4), 623–642.

Beer, M., & Cannon, M. D. (2004, Spring). Promise and peril in implementing pay for performance. *Human Resource Management Journal, 43*(1), 3–48.

Beer, M., & Eisenstat, R. A. (2000a). The organizational fitness profiling process. *Comportamentao Organizacional e Gestao, 6,* 1.

Beer, M., & Eisenstat, R. A. (2000b). The silent killers of strategy implementation and learning. *Sloan Management Review, 41*(4), 29–40.

Beer, M., & Eisenstat, R. A. (2004, February). How to hold an honest conversation about your strategy. *Harvard Business Review, 82*(2), 82–89.

Beer, M., Eisenstat, R. A., & Spector, B. (1990a). *The critical path to corporate renewal.* Boston: Harvard Business School Press.

Beer, M., Eisenstat, R. A., & Spector, B. (1990b, November–December). Why change programs do not work. *Harvard Business Review, 68*(6), 158–166.

Beer, M., & Gery, G. J. (1972). Individual and organizational correlates of pay system preferences. In H. L. Tosi, R. J. House, & M. Dunnette (Eds.), *Managerial motivation and compensation* (pp. 325–349). East Lansing: MSU Business Studies, Graduate School of Business Administration, Michigan State University.

Beer, M., & Katz, N. (2003). Do incentives work? The perceptions of a worldwide sample of senior executives. *Human Resource Planning Journal, 26,* 30–40.

Beer, M., & Nohria, N. (2000a). *Breaking the code of change.* Boston: Harvard Business School Press.

Beer, M., & Nohria, N. (2000b, May–June). Cracking the code of change. *Harvard Business Review, 78*(3), 133–141.

Beer, M., & Rogers, G. (1999). *Hewlett-Packard's Santa Rosa Systems Division, (A) (A1) (A2) (A3) (A4) (B3), case studies.* Boston: Harvard Business School.

Beer, M., Spector, B., Lawrence, P. A., Mills, D. Q., & Walton, R. (1985). *Managing human assets.* New York: Free Press.

Beer, M., & Weber, J. (1997). *Asda (A) (A1) (B) (C), case studies.* Boston: Harvard Business School.

Beer, M., & Weber, J. (2000). *Champion International, case study.* Boston: Harvard Business School Press.

Beer, M., & Weber, J. (2001). *Merck Latin America (A) (B) (C) (D), case studies.* Boston: Harvard Business School.

Bennis, W. (2000). Leadership of change. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 113–122). Boston: Harvard Business School Press.

Bennis, W. G. (1969). *Organization development: Its nature, origins, and prospects.* Reading, MA: Addison-Wesley.

Bunker, B., & Alban, B. T. (1997). *Large group interventions: Engaging the whole system in rapid change.* San Francisco: Jossey-Bass.

Burke, W. W. (1982). *Organization development: Principles and practices*. Boston: Little, Brown.

Burns, T., & Stalker, G. M. (1961). *The management of innovation*. London: Tavistock.

Business: Pay purview. (1998). *The Economist, 348*(8083), 59–60.

Cascio, W. F. (1993). Downsizing: What do we know? What have we learned? *Academy of Management Executive, 7*(1), 95–104.

Chandler, A. D. (1962). *Strategy and structure: Chapters in the history of the American industrial enterprise*. Cambridge: MIT Press.

Coch, L., & French, J. R. P. (1948). Overcoming resistance to change. *Human Relations, 1*, 512–533.

Collins, J. (2001). *Good to great: Why some companies make a leap and others don't*. New York: HarperBusiness.

Collins, J. C., & Porras, J. I. (1992). *Built to last*. New York: HarperCollins.

Conger, J. A. (2000). Effective change starts at the top. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 99–112). Boston: Harvard Business School Press.

Cummings, T. G. (1980). *Systems theory for organization development*. New York: John Wiley & Sons.

Deming, E. W. (1986). *Out of the crisis*. Cambridge: Massachusetts Institute of Technology, Center for Advanced Engineering Study.

Denison, D. R. (1990). *Corporate culture and organizational effectiveness*. New York: John Wiley & Sons.

Edmondson, A., & Woolley, A. (2003). Understanding outcomes of organizational learning interventions. In M. Easterby-Smith & M. Lyles (Eds.), *International handbook of organizational learning and knowledge management* (pp. 195–211). London: Blackwell.

Eisenhardt, K. M., Kahwajy, J. L., & Bourgeois, L. J., III. (1977, July–August). How management teams can have a good fight. *Harvard Business Review, 75*(4), 77–85.

Eisenstat, R. A., & Beer, M. (1997). *Organizational fitness profiling manual*. Waltham, MA: Center for Organizational Fitness.

Eisenstat, R. A., & Beer, M. (2002). *The strategic organizational fitness process handbook*. Waltham, MA: Center for Organizational Fitness.

Foster, R., & Kaplan, S. (2001). *Creative destruction: How companies that are built to last underperform the market—and how to successfully transform them*. New York: Currency.

French, W. L., & Bell, C. H., Jr. (1978). *Organization development: Behavioral science interventions for organizational improvements*. Englewood Cliffs, NJ: Prentice Hall.

Galbraith, J. (1978). *Organization design*. Reading, MA: Addison-Wesley.

Galbraith, J. (2000). The role of formal structure and process. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 139–158). Boston: Harvard Business School Press.

Gerstner, L. V. (2003). *Who says elephants can't dance: Inside IBM's turnaround*. New York: HarperBusiness.

Gibson, V. M. (1995). The new employee reward system. *Management Review, 84*(2), 13–18.

Gilson, S. C., & Cott, J. (1996). *Scott Paper, case study 9-296-048*. Boston: Harvard Business School.

Gittel, J. H. (2003). *The Southwest way: Using the power of relationships to achieve high performance*. New York: McGraw-Hill.

Grinyer, P. H., Mayes, D., & McKiernan, P. (1990). The sharpbenders: Achieving a sustained improvement in performance. *Long Range Planning, 23*, 116–125.

Hackman, J. R., & Oldham, G. R. (1980). *Work redesign*. Reading, MA: Addison Wesley.

Hambrick, D., & Siegel, P. (1997). *Compensation patterns within top management groups: On the harmful effects of executive pay disparities in high-technology firms*. Paper presented at the Academy of Management Meetings, Boston.

Heneman, R. L., Gresham, M. T., & Ledford, G. E., Jr. (2000). The changing nature of work and its effect on compensation design and delivery. In *Compensations in organizations* (Chapter 6). San Francisco: Jossey-Bass.

Heskett, J. L. (1999). *GE: We bring good things to life (A) (B), case studies*. Boston: Harvard Business School.

Heskett, J. L., Sasser, E. W., & Schlesinger, L. A. (2003). *The value profit chain: Treat employees like customers and customers like employees*. New York: Free Press.

Hirsh, S., & Kummerow, J. (1988). *Introduction to type in organizations*. Palo Alto, CA: Consulting Psychologists.

Huslid, M. (1995). The impact of human resource management practices on turnover, productivity and corporate financial performance. *Academy of Management Journal, 38*, 645.

Jensen, M. (2000). Value maximization and the corporate objective function. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 37–58). Boston: Harvard Business School Press.

Khurana, R. (2002a, September). The curse of the superstar CEO. *Harvard Business Review*, 3–8.

Khurana, R. (2002b). *In search of a savior*. Princeton, NJ: Princeton University Press.

Kotter, J. P., & Heskett, J. L. (1992). *Corporate culture and performance*. New York: Free Press.

Lawler, E. E. (1971). *Pay and organizational effectiveness: A psychological view*. New York: McGraw-Hill.

Lawler, E. E. (1981). *Pay and organization development*. Reading, MA: Addison Wesley.

Lawler, E. E. (2000). Pay system change: Lag, lead or both? In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 323–336). Boston: Harvard Business School Press.

Lawrence, P. R., & Lorsch, J. W. (1967). *Organization and environment: Managing differentiation and integration*. Boston: Graduate School of Business Administration, Harvard University Press.

Mallinger, M., as reported in Argyris, C., & Schon, D. A. (1993). *Organizational learning II: Theory, method and practice* (pp. 234–236). Reading, MA: Addison Wesley.

Miles, R. H. (2000). Accelerated organizational transformation: Balancing scope and involvement. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 381–389). Boston: Harvard Business School Press.

Miller, D. (1990). *The Icarus paradox: How exceptional companies bring about their own downfall*. New York: HarperBusiness.

Miller, D., Hartwick, J., & LeBreton-Miller, I. (2004). How to spot a management fad. *Business Horizons, 47*(3), 7–16.

Miller, D., & Lee, J. (2001). The people make the process: Commitment to employees, decision-making, and performance. *Journal of Management, 27*, 163–189.

Miner, J. B. (2002). Participative decision making. In J. B. Miner (Ed.), *Organizational behavior: Foundations, theories and analysis* (pp. 291–319). New York: Oxford University Press.

Morrison, E. W., & Milliken, F. J. (2000). Organizational silence: A barrier to change and development in a pluralistic world. *Academy of Management Review, 25*(4), 706–725.

Murphy, K., & Dial, J. (1993). *General Dynamics: Compensation and strategy (A) (B) case studies*. Boston: Harvard Business School Press.

O'Reilly, C. A., & Pfeffer, J. (2000). *Hidden value: How great companies achieve extraordinary results with ordinary people*. Boston: Harvard Business School Press.

Pfeffer, J. (1998). *The human equation: Building profits by putting people first*. Boston: Harvard Business School Press.

Schaffer, R. H. (1988). *The breakthrough strategy: Using short-term success to build the high performance organization*. Cambridge, MA: Ballinger.

Schaffer, R. H. (2000). Rapid-cycle success versus the Titanics: Ensuring that consulting produces benefits. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 361–380). Boston: Harvard Business School Press.

Schaffer, R. H. (2002). *High impact consulting: How clients and consultants can work together to achieve extraordinary results*. San Francisco: Jossey-Bass.

Schein, E. H. (1969). *Process consultation: Its role in organization development*. Reading, MA: Addison-Wesley.

Schein, E. H. (2003). *DEC is dead, long live DEC: The lasting legacy of Digital Equipment Corporation*. San Francisco: Berrett-Koehler.

Senge, P. (2000). *The puzzle of paradoxes and how living companies create wealth: Why single value objective functions are not quite enough*. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 59–82). Boston: Harvard Business School Press.

Tichy, N. M., & Sherman, S. (1993). *Control your destiny or someone else will*. New York: Harper Business.

Trist, E. (1969). On socio-technical systems. In W. Bennis, K. D. Benne, & R. Chin (Eds.), *The planning of change* (pp. 269–282). New York: Holt, Reinhart & Winston.

Tushman, M. L., & O'Reilly, C. A. (1997). *Winning through innovation: A practical guide to leading organizational change and renewal.* Boston: Harvard Business School Press.

Ulrich, D., Kerr, S., & Ashkenas, R. (2002). *The GE work-out: How to implement GE's revolutionary method for busting bureaucracy and attacking organizational problems—fast!* New York: McGraw-Hill.

Virany, B., Tushman, M. L., & Romanelli, E. (1992). Executive succession and organizational outcomes in turbulent environments. *Organizational Science, 3,* 72–91.

Vroom, V., Jago, A. J., & Arthur, J. (1988). *The new leadership: Managing participation in organizations.* Englewood Cliffs, NJ: Prentice Hall.

Walton, R. E. (1977, Spring). Successful strategies for diffusing work innovations. *Journal of Contemporary Business,* 1–22.

Walton, R. E. (1985). From control to commitment in the workplace. *Harvard Business Review, 64*(2), 76–84.

Walton, R. E. (1987). *Innovating to compete: Lessons for diffusing and managing change in the workplace.* San Francisco: Jossey-Bass.

Weisbord, M. R. (1991). *Productive workplaces: Organizing and managing for dignity, meaning and community.* San Francisco: Jossey-Bass.

Wruck, K. H. (2000). Compensation incentives and organizational change. In M. Beer & N. Nohria (Eds.), *Breaking the code of change* (pp. 269–305). Boston: Harvard Business School Press.

Zbaracki, M. J. (1998). The rhetoric and reality of total quality management. *Administrative Science Quarterly, 43,* 602–638.